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Lease accounting: Touche Ross interpretations of SFAS 13 -- February 28 1978

Touche Ross & Co.

LEASE ACCOUNTING

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INTRODUCTION

Statement of Financial Accounting Standards No. 13 is the latest in a series of professional or regulatory pronouncements addressing the troublesome subject of accounting for lease transactions. As SFAS 13 indicates, it derives from the notion that the transfer of substantially all the risks and benefits of ownership of property is a transaction which should be reflected in the financial statements of the transferor and the transferee. This is a relatively straightforward concept and seemingly would not be difficult to apply.

The Board, however, wrote a statement which consists of a specific set of precise rules founded upon a set of formalistic definitions which we believe results in the requirement to account for leasing transactions primarily by calculation rather than by judgment. We believe that SFAS 13 was designed to be adhered to literally and we have therefore taken a "strict constructionist" view of the statement.

SFAS 13 represents the present state of the art. We believe it is a step in an evolving process. The statement has already been amended once and interpreted officially once; presently there are two amendments and an interpretation in exposure. We believe there will be more interpretations; the statement will be modified, amended and ultimately replaced. Until then, as accountants we are bound to live with it and to apply it as best we can.

This compendium of questions and answers represents the current state of our thinking concerning the application of SFAS 13. It too will be interpreted, expanded, modified and ultimately replaced. Until then, it represents Touche Ross' approach to dealing with the problems we have encountered in trying to live with SFAS 13.

1. FAIR VALUE OF PROPERTY

Question: Classification of leases in accordance with SFAS 13 requires that the lessee deal with the fair value of the leased property. Sometimes the lessee has no knowledge of the cost of the property to the lessor (presumably, also its fair value). What should the lessee do in these circumstances?

Answer: The lessee must estimate the fair value. Very often the lessee does know the lessor's cost, particularly where the lessor is a financial institution and the lessee has in fact acquired the property for the lessor. In other situations, the lessee has probably made some sort of "buy or lease" analysis which is founded on the fair value of the property. Independent real estate brokers, or perhaps the company's own real estate department, could be useful in estimating fair value of realty. The key here is that the lessee must estimate.

2. PRICE LEVEL

Question: The possible existence of bargain purchase options or bargain renewal options in a lease is important to the classification of the lease. In addition, estimates must be made of residual values which will occur at the end of the lease term. Given a long-term inflationary trend, almost any stated amount could be construed to be a bargain twenty or twenty-five years down the road, or the residual could exceed initial cost. What inflation assumptions should be made in applying SFAS 13?

Answer: SFAS 13 does not contemplate inflation accounting in any respect. Since GAAP is framed in the premise of a constant price level, that premise should also apply to lease accounting. Accordingly, any renewal option or purchase option which is stated in terms of absolute dollars will be considered to be stated in today's dollars.

3. TERM OF LEASE -- OPTION TO RENEW

Question: The Statement (Paragraph 5f.) defines the lease term as including all periods, if any, covered by ordinary renewal options preceding the date as of which a bargain purchase option is exercisable. A lease for equipment has an initial term of ten years with an option to renew for a second ten years at the same price, with an option to purchase the equipment for $1 at the end of the renewal period. There is a clear expectation that the value of the equipment twenty years hence will be significantly greater than $1. It is not at all clear, however, that the utility of the equipment

during the second ten-year period will be sufficient to warrant exercising the renewal option, notwithstanding the existence of the option to buy for a buck. Does this situation indicate that the lease term is ten years or twenty years?

Answer: Based on the fact situation stated, the lease term is ten years and the bargain purchase option is disregarded. While exercise of the option is reasonably assured if available, the availability of the option is not reasonably assured; in order for the lessee to have the option he must renew the lease. Renewal of the lease as stated in the fact situation is not reasonably assured, so the existence (and therefore the exercise) of the bargain purchase option is not reasonably assured.

4. TERM OF LEASE -- RIGHT TO SUBLEASE

Question: SFAS 13 defines lease term as the fixed, noncancellable term of the lease plus certain other periods. A lease which runs for a certain period, say five years, but which requires the lessor to offer to sublease the property after three years at the same terms would seem to be the same as a lease which has a fixed, noncancellable term of three years. Is this correct?

Answer: No. The fact that the lessee can require the lessor to sublease the property creates a relationship between them, which is different from and which does not alter the primary lessor/lessee relationship. Therefore, we believe in this situation the lease term is five years for purposes of classifying the lease. If after three years, the parties go through with the sublease arrangement, the accounting for that transaction is governed by Paragraphs 35-40 of the statement. (If the parties intend for the lease to run for three years, with a two-year renewal option, it would seem that they could accomplish their intention by writing it that way.)

5. ESTIMATED ECONOMIC LIFE OF LEASED PROPERTY

Question: The definition (Paragraph 5g.) of estimated economic life of leased property is as follows: "The estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term." What is the meaning of the phrase, for the purpose for which it was intended at the inception of the lease?

Answer: The "purpose of use" concept can mean different things to the different parties to a lease. The lessor of a free standing one story building, for example, may view his property as being usable by any number of

tenants for any number of purposes, while the retail grocer-lessee of that property views its use as a supermarket. If the "intended use" is that which is viewed by the lessee, the useful life may well be a relatively short period, perhaps no more than 15 or 20 years. If, on the other hand, the intended use applies to the lessor, the property is usable as long as it stands. We believe neither of these extreme positions to be justified; the use of a retail property after the primary lease term must be considered in light of general retail businesses.

6. CONTINGENT RENTALS

Question: Some leases provide for payment of rentals based on something other than the passage of time. Leases for shopping center store sites often provide for rents based on a percentage of sales, subject to a minimum stated amount. Some leases are tied to interest rates, where rentals vary according to some measure, such as the prime rate. How are such contingent rentals treated in determining the classification of leases?

Answer: This is a very complex question because of the almost infinite variety of contingency provisions possible in leases. The general rule is, contingent rentals should not be included in the determination of minimum lease payments. This generality, however, must be modified. Situations exist where the "contingency" is not subject to any influence by either party to the lease and is so remote as to be nonexistent for all practical purposes. If these conditions exist, the rent is not contingent and should be included in the minimum lease payment. The amount to be included may be the amount below which the likelihood of nonpayment is remote. Some examples of this distinction between contingent and noncontingent follow:

(a) A twenty-year lease calls for rentals of $100,000 a year beginning in year three. For years one and two, the annual rent is to be the product of $1,500,000 times the prime interest rate. Since the amount of rent for the first two years will vary with changes in the prime interest rate, there are those who would argue that the entire rental for those years should be disregarded. We believe this is an incorrect interpretation. There will be a prime interest rate; therefore, there will be some amount of rental. Neither the lessor nor the lessee can influence the rate; therefore, we believe some amount must be included in the calculation of minimum lease payments. The present prime rate is 7% and, based on reasonable investigation, we conclude that the likelihood of the prime rate falling to 6% is "reasonably possible," but the likelihood of a rate below 6% is "remote"; we should use 6% to calculate the first two years' rent.

(b) A lease on a retail store site calls for annual rental of 1,000% of the first $25,000 annual sales. Attainment of that sales level is virtually certain so long as the store stays open. There are, however, no legal or contractual requirements for the company to keep the store open. Because the lessee can influence the amount of the rent, in this case the rent is contingent and should not be included. Note that contracts outside the lease, perhaps with parties other than the lessor (e.g., merchants' associations or labor unions) might require the lessee to keep the store open.

7. AUDIT EVIDENCE--LEASE CLASSIFICATION

Question: The client is lessee of many pieces of similar equipment obtained from one lessor. The lessor has given the client a letter stating in part as follows, "Please be advised that while we do not provide accounting advice, we treat all existing leases, including those on which you are the lessee, as operating leases for our own internal accounting purposes. This lease classification has been reviewed with our independent accountants who concur with our classification." Recognizing the concept of symmetry in SFAS 13, would such a letter constitute sufficient evidence in support of the client's classification of these leases as operating leases?

Answer: No. We cannot rely on such a letter; the client must make his own determination based on a review and analysis of his leases. We must then challenge these determinations.

8. EXECUTORY COSTS

Question: Minimum lease payments, as defined (Paragraph 5j. and Paragraph 7b.), exclude executory costs. Are there any guidelines dealing with what constitutes executory costs, or how such costs should be estimated?

Answer: Executory costs are those incurred in connection with owning and operating the property; they do not include costs incurred in connection with acquiring either the property or the lease. Examples of the former (qualifying) are repairs and maintenance, insurance, and property taxes. Examples of the latter (nonqualifying) are commissions, finders' fees, freight and installation. Estimates of executory costs should be based on the company's experience with similar property, or the advice of experts such as insurance brokers, or reference to tax valuation methods and rate structures. Estimates of executory costs should consider the behavior of such costs over time. For example, repairs and maintenance would be expected to rise while property taxes based on book value would decline. Note that profit on executory costs is also to be considered, and typically would require an estimate of a reasonable percentage of the estimated costs.

9. EXECUTORY COSTS - AUDITING

Question: If the lease specifies an amount of executory costs to be paid by the lessee to the lessor, is it still necessary to estimate these costs?

Answer: Yes. Even though stated, the actual executory costs must be estimated because the stated amount must pass the test of reasonableness.

10. IMPLICIT INTEREST RATE

Question: The interest rate to be used in testing lease classification and in capitalizing leases is required by the Statement to be the lessee's incremental borrowing rate, unless it is practicable for the lessee to learn the lessor's implicit rate and that rate is lower than the incremental rate. Under what circumstances is it "practicable for the lessee to learn" the lessor's implicit rate?

Answer: Almost always, the only way the lessee can learn the implicit rate is to be told by the lessor. The implicit rate is a function of the lessor's estimates, both of the present fair value of the leased property and of the residual value of that property. The rate may also be affected by other factors totally extraneous to the lessee (e.g., lessor's tax status). We believe, therefore, that it will be impossible for the lessee to determine the lessor's implicit rate absent the lessor telling him.

11. IMPLICIT INTEREST RATE - AUDITING

Question: As auditors, what procedures should we perform to determine that it is appropriate for our client, the lessee, to use his incremental borrowing rate rather than the lessor's implicit rate?

Answer: We should determine that the client has asked the lessor what the implicit rate is. The client should inquire in writing and keep the request copy in file. We expect that most often lessors will not respond positively to such requests. Further, given the economics of leasing, we would expect that only rarely would the implicit rate be lower than the lessee's incremental borrowing rate.

12. MINIMUM LEASE PAYMENTS

Question: Our client is lessee under a lease covering a building. The lessor is a limited partnership of investors organized to acquire the property and enter the lease. The general partner is the "deal maker" who is paid a fee to compensate for his role. The fee is

paid directly by our client, in lieu of the first year's rent. Should this payment be included in the determination of minimum lease payments?

Answer: Yes. Regardless of how the payment is structured, compensation to the promoter is a cost to be borne by the limited partnership as a matter of economic reality, and it is not an executory cost. While, for purposes of making the "90% test" (Paragraph 7d.), the compensation should be included in the numerator as rent, it should also be included in the denominator as part of the fair value of the property.

13. SALES-TYPE LEASES INVOLVING REAL ESTATE

Question: SFAS 13 (Paragraph 8) provides that a lessor account for a lease as a sales-type lease if all other classification criteria apply and if collectibility of the minimum lease paymewnts is reasonably predictable. The AICPA Industry Accounting Guide, Accounting for Profit Recognition on Sales of Real Estate, imposes requirements for minimum downpayment and for continuing payments from the buyer, in order for the profit to be recognized on the sale of real estate. Is there any inconsistency between these two documents which permits profit recognition if the form of a real estate transaction is that of a lease but precludes profit recognition if the form is that of a sale?

Answer: The apparent inconsistency is not real. The Accounting Guide does not preclude recording the transaction as a sale if it does not meet the downpayment requirements; it precludes only the recognition of profit. On the other hand, SFAS 13 does not mandate that profit on sales-type leases be immediately recognized. We believe that the guidelines contained in the Accounting Guide regarding profit recognition are appropriate and applicable to real estate transactions conducted in the form of leases; until the Accounting Guide requirements for buyer investment in the property would permit recognition, profits on sales-type leases should be deferred.

14. ACCELERATING LEASE PAYMENTS

Question: Leases sometimes call for rental payments which are lower in the early years and subsequently increase. What is the accounting for a capital lease which has such a provision and as a result the early payments are not sufficient to cover "interest" on the capitalized obligation?

Answer: SFAS 13 (Paragraph 12) requires that interest on the capitalized obligation be charged on the "interest method," which results in a constant interest rate on the outstanding balance over the amortization period.

This charge, then, would result in an accrual of unpaid interest in the early period of the lease when the lease payments are insufficient to cover the interest expense.

15. LEASE TERM

Question: A lease which is classified as an operating lease has a renewal option calling for less rent during the option period. SFAS 13, Paragraph 15, requires rental expense to be recognized on a straight-line basis or on some other systematic and rational basis, even though rental payments are made on some other basis. In this situation, should a portion of the rental payments during the primary lease term be deferred to the option period?

Answer: If the reduced rent causes the option to be a "bargain renewal option" as defined, and the lease still is classifiable as an operating lease, then the front end rental payment should be deferred in part so the expense is constant over the total lease term, including the option period. If, on the other hand, the renewal option is not a "bargain," it is treated as though it were a new lease. Rental expense in that case would not be adjusted to reflect the option period rental.

16. LEASE IN SUBSTANCE INSTALLMENT PURCHASE

Question: Companies often arrange with Industrial Development Authorities to have factories financed by IDA bonds. The form of some of these transactions is such that, legally, the authority owns the property and the company is lessee. The lease typically calls for rental payments equal to the bond principal and interest, with an option to buy the property at any time for the amount required to retire the bonds outstanding. After the bonds are all retired, title runs to the company for virtually no additional consideration. Before SFAS 13, these arrangements were capitalized as installment purchases and the underlying Authority bonds were recorded as though they were debt of the company. SFAS 13 would not alter the accounting for these leases, but Paragraph 16 of the Statement imposes disclosure requirements which seem inappropriate to the type of arrangement described here. Are these disclosures required?

Answer: Yes. SFAS 13 applies to this type of arrangement, and disclosure as a lease, rather than as debt, is required. However, if the client prefers to continue the disclosure as in the past, we will not object, because we believe the fact of disclosure is important, rather than the location of that disclosure.

17. LEASE OF LAND IMPROVEMENTS

Question: Does SFAS 13 provide any guidance concerning the accounting for a lease covering improved land, for example a paved parking area or a vineyard?

Answer: While not speaking specifically to these kinds of improvements, SFAS 13 can be interpreted to deal with them in the same connection as it deals with leases covering land and buildings. Land improvements in this context are analogous to buildings in that they are depreciable property and are therefore consumed, at least in part, during the rental period. Paragraph 26 of SFAS 13 should be followed in accounting for leases covering both depreciable and nondepreciable property, with the depreciable elements being read "building."

18. LEASES INCLUDING LAND AND BUILDING

Question: For leases covering both land and building, SFAS 13 (Paragraph 26b.) requires different accounting, depending on whether the land value is more or less than 25% of the total value of the leased property. A company has a number of land and building leases, all similar, all with land values approximating 25%, but some more than 25% and some less. Does this company have to account for some of the leases one way and some the other?

Answer: Yes. Each lease must be evaluated on its own.

19. LEASE FOR PART OF A BUILDING

Question: SFAS 13, Paragraph 28, recognizes that the fair value of a part of a property may not be objectively determinable. The example used in the statement is an office or a floor of a multi-story building. Can the same concept apply to a store in a shopping center or enclosed mall?

Answer: Yes. Very often it will be impossible for the lessee to determine the fair value of his store site. Many interdependent variables determine the value of a shopping center. Not the least of these determinants is the bundle of leases for the center. So, in effect, the other leases determine to some extent the value of a particular store site. If the lease, however, covers a significant portion of the property, we believe it becomes more feasible to determine the fair value of the portion under lease, and we would require that our client attempt to do so.

20. RELATED PARTIES

Question: A company is closely held, with the president owning a majority of its stock. The president is the lessee of land and building which is occupied by the company. The arrangement between the company and the president is informal; there is no written lease and rental is month-to-month. The president, as lessee, has a bargain option to buy the property so the lease is a capital lease as to him. This type of property is not normally available for lease on a month-to-month basis. Is there any basis to capitalize this lease on the financial statements of the company?

Answer: Yes. SFAS 13 (Paragraph 29) speaks to form versus substance in related party leases. (Editor Note: Interestingly, this is the only context in which form versus substance is recognized in SFAS 13.) The test which related party leases must pass is whether similar property is available for lease with unrelated parties at the same terms and prices. In this fact situation we would conclude that the terms have been affected by the relationship of the parties and we would "adjust" the terms; this is best accomplished by considering the company, rather than the president, to be the lessee under the primary lease. A footnote to the financials should disclose the legal form of this related party transaction.

21. RELATED PARTY LEASES

Question: SFAS 13 seems to liberalize the accounting treatment given to related party leases. In many instances, for example, the shareholders of closely-held companies lease property to those companies. Under APB 5, these leases have been capitalized, or, if not, the auditors qualify their opinion on the financial statements. Assuming that substance is the same as form, if a related party lease would be classified as an operating lease under SFAS 13, how should these leases now be accounted for?

Answer: If a company early-adopts SFAS 13 (or when a company ultimately adopts), any previous financial statements which include capitalized leases should be restated to account for them as operating leases if such leases pass a very strict "substance vs. form" test and are appropriately operating leases. An auditor's qualification would not be appropriate any longer for financials in which these leases were not capitalized since GAAP has now conformed to the company's reporting practice. We must emphasize, however, that this answer is prefaced on the company's early-adopting all of SFAS 13 and not just the good parts.

22. PURCHASE BUSINESS COMBINATION

Question: The Statement defines inception of the lease as the date of the lease agreement or the date of a written lease commitment, if earlier. In a business combination accounted for as a purchase, the acquired company must be "fair valued" taking into account all of its resources and obligations, thus deriving a new basis of accountability. Does this mean that a lease obtained in a purchase business combination is considered a new lease for purpose of applying SFAS 13?

Answer: No. Because the entity which was the original party to the lease becomes part of the larger entity, the lease is considered to be the same old lease unless its terms are changed.

Note that the APB 16 (Paragraph 88) requirement that values be assigned to favorable or unfavorable leases as part of the purchase price allocation is not affected by SFAS 13. So, if an acquired company has a favorable lease which at inception was classified (in accordance with SFAS 13 criteria) as an operating lease, that lease will remain an operating lease; the amount attributable to the "favorable terms" will be recorded as an intangible asset and amortized over the remaining lease period. If the lease had been a capital lease, it will remain a capital lease. The asset and the liability both will be fair-valued and those values amortized over the remaining life of the lease. The fair value of the liability is determined by the current interest rate, while the fair value of the asset is determined by the market rate of rentals for similar property.

23. LEVERAGED LEASING--INVESTMENT TAX CREDIT

Question: The Statement (Paragraphs 43 - 47) specifies the method of accounting for leveraged leases, as that term is defined by the Statement. Paragraph 43 states that the investment tax credit must be deferred. However, a footnote to Paragraph 42 notes that, "It is recognized that the investment tax credit may be accounted for other than as prescribed in this Statement, as provided by Congress in the Revenue Act of 1971." Does this mean that a company may account for the investment tax credit by the flow-through method and still account for leveraged leases in accordance with these paragraphs?

Answer: No. The footnote recognizes that a company may account for the investment credit however it chooses. However, if it chooses to account for the investment credit other than as prescribed in Paragraph 43, it cannot use the leveraged lease accounting provisions of the Statement.

24. INCEPTION OF THE LEASE

Question: A publicly-held company has a revolving lease agreement with a financial institution which permits the company to lease equipment up to a specified dollar amount of outstanding future lease payments. All the terms of the lease are stated in the master lease, except the monthly rent which is stated as a percentage of the fair value of property under lease. Are the 1977 additions to leased property to be classified in accordance with SFAS 13, or are these additions considered to be covered under lease commitments existing at January 1, 1977 and therefore not classified until the Statement is adopted in 1978?

Answer: The inception of the lease is considered to be when the master lease was written, all of the important terms having been defined at that time. The 1977 additions therefore would come under Paragraph 48 of SFAS 13 which deals with transactions consummated after 1976 under terms of commitments which existed before January 1, 1977, and would be classified in accordance with preexisting principles until SFAS 13 is retroactively adopted.

25. ACCOUNTING FOR SALES OF LEASES

Question: A manufacturer/lessor has a number of leases accounted for under APB 7 as operating leases, which will meet the classification criteria of SFAS 13 as "sales-type leases." The adoption of SFAS 13 by this company will result in retroactive recognition of significant income in earlier years. If, before retroactive adoption of SFAS 13, the company were to sell the equipment subject to these leases, at a price in excess of net book value, would this transaction give rise to income in that year?

Answer: Yes, but. SFAS 13 (Paragraph 51) requires that financial statements be restated to include the effects of any leases that were in existence during the periods covered by the financial statements even if those leases are no longer in existence. When SFAS 13 is retroactively adopted, therefore, the profit on these sales-type leases would be pushed back to the year of inception of the lease regardless of any later disposition of those leases. Because the company knows its financial statements will have to be restated, that fact and the effect of the restatement must be disclosed; we would expect such disclosure would be awkward to make.

The SEC, by issuing ASR 225 which requires 1978 adoption of SFAS 13 for calendar year companies, has made this question now moot for many public companies.

26. LEASE ACCOUNTING--1978 INTERIM FINANCIAL STATEMENTS

Question: Publicly-held companies will adopt the provisions of SFAS 13, beginning with calendar 1978 financial statements, as mandated by ASR 225 (and confirmed by ASR 235). The ASR does not require adoption for 10-Q financial statements any earlier than December, 1978. APB 28 (Paragraph 28), on the other hand, states, "The Board recommends that, whenever possible, companies adopt any accounting change during the first interim period of a fiscal year." What advice should we give to clients concerning their quarterly reporting in 1978?

Answer: We should recommend that public clients adopt ASR 225 in the first quarter of 1978. If a client rejects this recommendation, the client must disclose the requirement to adopt at year-end and estimate the effect of restatement on the quarterly financials. If the client does not make that disclosure and if we are associated with the quarterly financials on a timely basis, our report must comment on the absence of disclosure (but not on the failure to early-adopt).

We should remind the client that, if he is required to include quarterly figures in the 1978 annual report (ASR 177), those figures will have to be restated to reflect the year-end adoption of SFAS 13.

27. IMPLEMENTATION - RESIDUAL VALUES

Question: In order to apply SFAS 13 to existing leases, estimates of residual values must be made. How should this process be approached?

Answer: The estimate of residual values theoretically should be made as though they were being made at the inception of the lease. As a practical matter, this is a very hard thing to do; it is difficult not to consider current facts in the estimating process. A viable approach might be to determine residual values of similar new equipment and relate the percentage of residual to cost back to the old equipment. Another approach might be to determine the current estimate of residual value of the old equipment and index that value back to the lease inception.

28. ADOPTION OF SFAS 13-- RESTATEMENT OF PRIOR PERIODS

Question: Adoption of SFAS 13 requires restatement of prior years' financials when presented for comparative purposes. Paragraph 51c. says that financials for 1976 and prior should be restated for as many periods as is

practicable. Paragraph 51d. says that the cumulative effect on retained earnings at the beginning of the earliest period restated must be included in income of that period. If, for example, a company presents income statements for 1973 through 1977, having restated all of those years, is a cumulative catch-up required in the 1973 income statement?

Answer: No. If it is practicable to restate 1972 income, that should be done, even though 1972 is not presented. The cumulative catch-up, then, would be included in opening retained earnings for 1973, rather than in 1973 income.

29. INITIAL DIRECT COSTS

Question: SFAS 17 has amended SFAS 13 to expand and clarify the definition of initial direct costs. Initial direct costs are those which must be deferred by the lessor for operating leases; for capital leases, initial direct costs are charged to income as incurred, but an equal amount of unearned income must be recognized immediately, so the effect on current income is the same as cost deferral. The Amendment seems to expand the concept of initial direct costs. What type of costs would be includable?

Answer: SFAS 17 does indeed expand the concept of initial direct costs. As defined by SFAS 13, these were restricted to incremental direct costs; they were only those costs incurred because of the specific leasing transaction which would not have been incurred otherwise. The definition of initial direct costs now includes costs related to the general level of leasing activity, but which are not necessarily incremental to any specific lease. The prime examples of the now-includable costs are salaries of lease negotiators and in-house legal counsel. Inclusion of compensation of these people is permitted based on the time they devote to successful leasing activities. Indirect costs, such as administrative overhead and space rent, are still not includable.

An example of expense allocation follows:

Expense	Total	Allocation basis	Includable in initial direct costs*
Salaries - legal staff	$ 65,000	A	$46,000
Salaries - sales staff	160,000	A	57,000
Bonus - sales staff	30,000	C	30,000
Salaries - office	42,000	D	-
Rent and other occupancy costs	35,000	D	-
Data processing service	17,000	B	3,000
Legal filing fees	8,000	C	8,000
Credit investigations	6,000	B	4,000
Finders fees	40,000	C	40,000

Allocation basis:
A = Time sheets -- dollars per hour, times hours charged for successful efforts.
B = Ratio of successful efforts to total efforts.
C = Directly related to successful efforts.
D = Not allocable.

*Hypothetical.

30. CURRENT EXPOSURE DRAFTS

Question: The FASB has recently (December 19, 1977) issued three exposure drafts to amend or interpret SFAS 13. These cover the following topics:

1. Inception of the lease (an amendment).

2. Changes in the provisions of lease agreements resulting from refundings of tax-exempt debt (an amendment).

3. Accounting for leases in a business combination (an interpretation).

The two amendments are in direct conflict with present requirements of SFAS 13. How should this conflict be resolved?

Answer: The exposure drafts have no status until they are adopted by FASB. Conflict therefore must be resolved by following the requirements of the existing SFAS 13. If application of an exposure draft would result in a significantly different accounting treatment, the existence of the draft and the difference should be disclosed.

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